



FINANCIAL SECTION



INDEPENDENT AUDITORS' REPORT

The County Commissioners of
Caroline County
Denton, Maryland

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund and the aggregate remaining fund information of The County Commissioners of Caroline County, Maryland (the "County") as of and for the year ended June 30, 2012, which collectively comprise the County's basic financial statements, as listed in the table of contents. These financial statements are the responsibility of the County's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of Dayspring Townhomes. Those financial statements were audited by another auditor whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for Dayspring Townhomes is based on the reports of the other auditor.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the reports of the other auditor provide a reasonable basis for our opinions.

In our opinion, based on our audit and the reports of the other auditor, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund and the aggregate remaining fund information of the County as of June 30, 2012, and the respective changes in financial position, and, where applicable, cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 24, 2012, on our consideration of the County's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and

other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and the required supplementary information, as listed in the table of contents, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the County's basic financial statements as a whole. The introductory section, other supplementary information, and statistical section, as listed in the table of contents, are presented for purposes of additional analysis and are not a required part of the basic financial statements. The other supplementary information have been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole. The introductory and statistical sections have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide assurance on them.



Salisbury, Maryland
October 24, 2012

Executive Summary
Management Discussion and Analysis
Caroline County Government, FY 12 Financial Audit

“This MD&A section of the financial report should be brief and objective and should be easily readable by an average reader, one not possessing a detailed knowledge of accounting.” Government Accounting Standards Board, Statement 34

The financial condition of Caroline County government is not readily apparent to local residents. Since the economic downturn in 2007, citizens have received much the same level of County services despite the prolonged economic downturn, severe cuts in state funding to local governments, and the substantial decreases in property and income tax revenues. The shrinking of the County budget (cutting expenditures from \$47.4 million in FY 07 to \$41.4 million in FY 12) has occurred largely through deferring infrastructure maintenance and capital expenditures.

In FY 12, the County managed a modest reversal of this trend by investing \$1.2 million in infrastructure and capital. These funds generally came from nonrecurring sources like a major school renovation coming in under budget and a remarkably mild winter. While the County made some progress on roadway maintenance, the linear miles of tar-and-chip retreatment fell short of that required to maintain an optimal once-per-seven-year cycle. A small number of vehicles were replaced but the cumulative shortfall in fleet-wide vehicle and equipment replacement reached \$2.25 million.

On the revenue side, property and income tax revenues remained substantially lower than historic highs. The County’s property tax rate was increased to the “constant yield” level. To explain, an increase of two cents was necessary to maintain property tax revenues at the level of the prior fiscal year. The Commissioners contemplated a larger (five cent) property tax increase; however, they chose to honor a commitment to only increase taxes enough to cover the cost of teacher pensions. Because of a one-year “disparity grant” provided by the State, the first-year cost of teacher pensions was substantially less than anticipated. The management team recommended an increase in the County’s income tax to achieve better balance between property and income tax revenue streams. The Commissioners considered this request, but declined to make any change.

On the expenditure side, the County continued to operate under an austerity budget. For the fourth consecutive year, County employees did not receive a pay increase. One fulltime position was eliminated; another was replaced with a half position. The County absorbed a 25 percent increase in the required contribution for the employees’ pension plan, a cost of over \$250,000. Caroline County is one of two counties in the state where an employee contribution is not required to participate in the defined

benefit pension plan. During FY 12, the County Commissioners approved changes to reduce the unfunded liability related to unused sick leave. This includes allocating \$65,000 per year to pay down existing sick leave balances.

No new debt was issued; however, the Commissioners made commitments to two major capital projects: the renovation of Preston Elementary School and the construction of the Allied Health/Gymnasium project at Chesapeake College. While the Commissioners voted against the Allied Health/Gymnasium project, a majority of Midshore counties voted to approve it. Under state law, the County is obligated to fund the project.

During FY 12, Caroline County maintained an unassigned fund balance of over five percent of total budgeted general fund expenditures—a “rainy day” fund intended to provide funds in the event of an emergency or natural disaster. As noted, some one-time events temporarily increased the fund balance. After careful deliberation, the Commissioners voted to use the balance in excess of the minimum required reserve on priority capital and infrastructure projects.

The County continued its strong support of allied agencies. This includes funding “maintenance of effort” for the local Board of Education. The County believes the allied agencies are well managed and prudent with regard to fiscal management. During FY 12, the most significant budget over expenditure occurred in the Caroline County Board of Elections.

During the 2012 legislative session, there were several major actions impacting local government finances, most notably the shift in responsibility for funding teacher pensions to the counties. In FY 14, the County anticipates having to pay the full amount for teacher pensions, approximately \$1.2 million in the first year and an increasing amount thereafter.

Despite the adverse fiscal climate, the State of Maryland continued to press unfunded mandates including the Watershed Implementation Plan (WIP) initiative. This regulatory scheme represents a potential cost of \$168 million for Caroline County, a cost of over \$13,000 per household. The State also passed new laws and implemented regulations which stand to greatly limit the potential for rural development, particularly residential housing on private wells and septic systems. This may have long-term negative impacts on the County economic development.

While local residents have not experienced significant tax increases or reductions in services, the County’s roads, vehicles and buildings continue to age. The County made some progress in addressing this shortfall in FY 12, however, the financial challenges of deferred maintenance and capital investment remain daunting.

Management's Discussion and Analysis

This narrative section of the Comprehensive Annual Financial Report of Caroline County, Maryland presents an overview and analysis of the financial activities of Caroline County's Government for the fiscal year ended June 30, 2012. Descriptions in this section, along with the financial statements and notes and the letter of transmittal provide readers with both broad and detailed information.

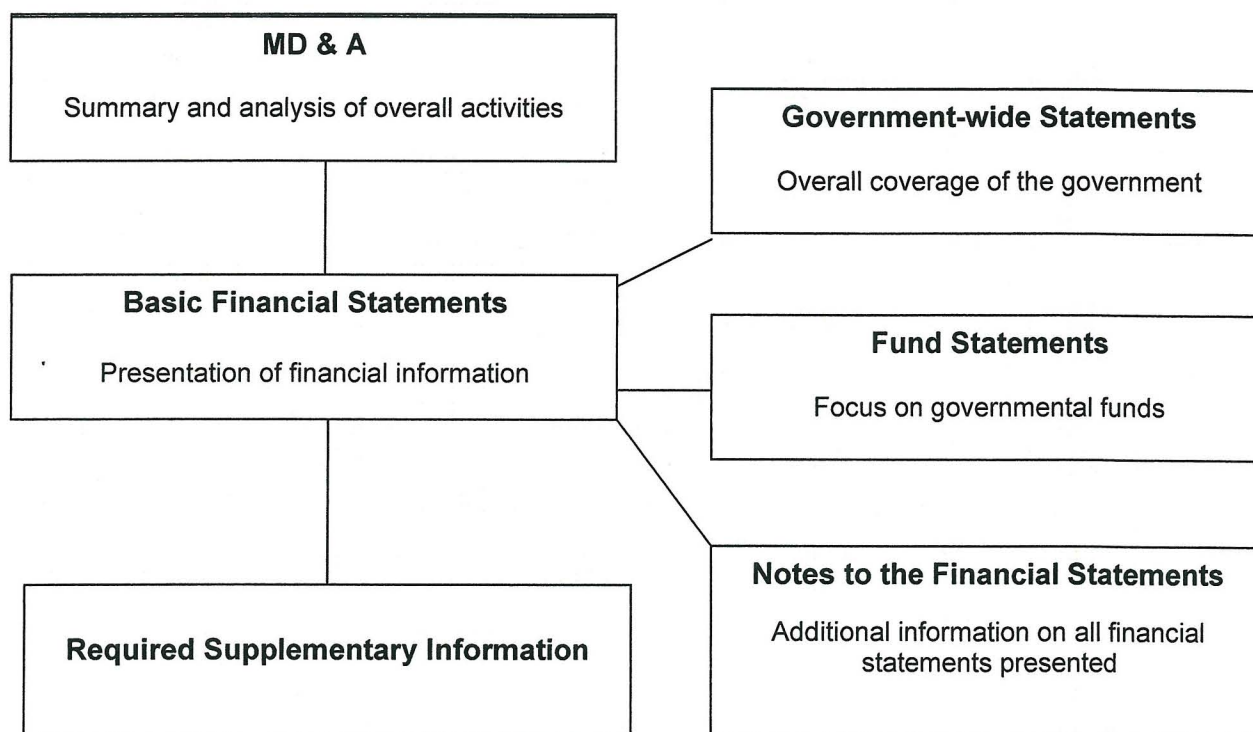
Financial Highlights

- Total fund balance for the General Fund was \$3,738,944 at June 30, 2012.
- The assets of Caroline County exceeded liabilities at the close of the current fiscal year by \$ 30,598,939 (net assets). Of total net assets, \$6,972,914 (unrestricted net assets) may be used to meet the County's ongoing obligations to its citizens and creditors.
- The primary government's total net assets decreased by \$472,269 compared with the prior year. The primary government includes Caroline County Government, but excludes Caroline County Board of Education and the Caroline County Public Library, which are component units. The County is responsible for the fiscal support of component units' projects, but does not hold possession of the assets.
- As of June 30, 2012, the County's governmental funds reported combined fund balances of \$7.5 million, a decrease of \$1.6 million from the prior year. Approximately \$3.5 million is available to meet the County's current and future needs (unassigned fund balance). The remaining \$4 million has not been budgeted for use in the FY 2013 budget.
- Unassigned fund balance for the General Fund was \$3,542,706 for the year ended June 30, 2012.
- Long-term Liabilities include approximately \$ 30.8 million in bonds payable, approximately \$ 3.5 million in loans and notes payable, and landfill closure costs of approximately \$ 2.4 million.

Overview of the Financial Statements

This discussion and analysis offers an introduction to the County's basic financial statements. Caroline County's basic financial statements include three components: (1) government-wide financial statements, (2) fund financial statements, and (3) notes to the financial statements. This report contains other supplementary information in addition to the basic financial statements themselves. The diagram below illustrates how each element of the statements can be used to enhance the overall understanding of the information presented.

Financial Statement Presentation



Government-wide financial statements (Reporting on the County as a whole)

The government-wide financial statements provide a broad overview of Caroline County Government's finances. The Statement of Net Assets and the Statement of Activities are prepared using the accrual basis of accounting.

The Statement of Net Assets presents information on all of the County's assets and liabilities, with the difference between the two reported as net assets. Over time, increases and decreases in net assets may serve as a useful indicator of whether the financial position of the County is improving or declining.

The Statement of Activities presents information regarding changes in the County's net assets during the most recent fiscal year. Changes in net assets are reported as soon as the event creating the change occurs, regardless of the timing of related cash flows.

Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (e.g., uncollected taxes and earned but unused vacation leave).

Both of the government-wide financial statements distinguish functions of the County that are principally supported by taxes and intergovernmental revenues (government activities) from other functions that are intended to recover all or a significant portion of their costs through user fees and charges (including enterprise activities). The governmental activities of the County include general government, public safety, detention center, planning, codes enforcement, education, highway and street maintenance, health, parks and recreation. The enterprise activities of the County include Emergency Medical Services, Recreation and Parks, Public Works enterprise fund, and Broadband.

The government-wide financial statements include not only the operations of Caroline County Government itself (known as the primary government), but also the legally separate organizations of the Board of Education of Caroline County, Maryland and the Board of Library Trustees for Caroline County, Maryland. The financial information for these component units is reported separately from the financial information presented for the primary government. The government-wide statements can be found within this report, as listed in the table of contents.

Fund financial statements (Reporting the County's Most Significant Funds)

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The County, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the County can be divided into three categories: governmental funds, proprietary funds, and fiduciary funds.

Governmental funds – Governmental funds are used to account for essentially the same functions reported in the government-wide financial statements. Unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of resources, as well as on balances of resources available at the end of the fiscal year. Such information may be useful in evaluating a government's near-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term affects of the government's near-term financing decisions. Both the governmental fund Balance Sheet and the governmental fund Statement of Revenues, Expenditures, and Changes in Fund Balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

Caroline County Government maintains twenty-two individual governmental funds. Information is presented separately in the governmental fund Balance Sheet and in the governmental fund Statement of Revenues, Expenditures, and Changes in Fund

Balances for the General Fund, the Capital Improvements Fund, Capital Reserve Fund, and the Special Grants Fund, which are considered to be major funds. Data from the other eighteen governmental funds are combined into a single, aggregated presentation. The basic governmental fund financial statements can be found within this report, as listed in the table of contents.

Proprietary funds – Proprietary funds include internal service funds and enterprise funds. An internal service fund is an accounting device used to accumulate and allocate costs internally among the County's various functions. Caroline County does not maintain any internal service funds. The County uses enterprise funds to account for its recreational programs, Public Works charges for services, Basic Life Support function, and Broadband.

Proprietary fund financial statements provide the same type of information as the government-wide financial statements, only in more detail. The Recreation Program and Public Works funds are combined while the Basic Life Support and Broadband Supply funds are considered major funds and presented separately. The basic proprietary fund financial statements can be found within this report, as listed in the table of contents.

Fiduciary funds – Fiduciary funds are used to account for resources held for the benefit of parties outside the County. Fiduciary funds are not reflected in the government-wide financial statements because the resources of those funds are not available to support the programs managed directly by the County Commissioners and their staff.

Fiduciary funds include four fund types –benefit trust funds, investment trust funds, private-purpose trusts, and agency funds. The County does not maintain any private-purpose trusts or investment trust funds. The County maintains nine agency funds: State Property Tax Fund, Town Property Tax Fund, Hotel Rental Tax, Tax Sale Proceeds Fund, Inmate Account, Confiscated Properties Fund, Bay Restoration Fund, Public Drainage Association and Home Builder Guaranty Fund. The Fireman's Association Fund (LOSAP), the Retiree Health Care Fund, the Employees' Pension Plan and OPEB Trust Funds are benefit trust funds. The fiduciary fund financial statements can be found within this report, as listed in the table of contents.

Notes to the financial statements. The notes provide additional information that is essential to creating a full understanding of the data provided in the government-wide and fund financial statements. The notes to the financial statements can be found within this report, as listed in the table of contents.

Other information. In addition to the basic financial statements and accompanying notes, this report also presents certain required supplementary information and disclosures that are not considered a part of the basic financial statements. Schedules included in this section are: 1) budgetary comparison for the both the General Fund and Special Revenue Grants Fund to demonstrate compliance with the annually adopted budget, and 2) schedules showing the County's progress in funding its obligation to provide pension benefits to its employees. These reports are located immediately following the notes to the financial statements, as listed in the table of contents.

Government-wide Financial Analysis

This is the tenth reporting period in which Governmental Accounting Standards Board (GASB) Statement No. 34 has been applied in the preparation of the financial statements of Caroline County Government.

A summary of government-wide assets, liabilities, and net assets is as follows:

	Governmental Activities		Business-type Activities		Total	
	2012	2011	2012	2011	2012	2011
Current and other assets	\$14,060,559	\$16,552,149	\$1,102,661	\$931,451	\$15,163,220	\$17,483,600
Capital assets, net of depreciation	57,741,696	59,571,383	345,023	335,514	58,086,719	59,906,897
Total assets	71,802,255	76,123,532	1,447,684	1,266,965	73,249,939	77,390,497
Noncurrent liabilities	40,825,902	44,083,544	-	-	40,825,902	44,083,544
Other liabilities	1,328,634	1,638,647	496,464	597,098	1,825,098	2,235,745
Total liabilities	42,154,536	45,722,191	496,464	597,098	42,651,000	46,319,289
Net assets:						
Invested in capital assets, net of related debt	22,018,273	22,611,390	345,023	335,514	22,363,296	22,946,904
Restricted	1,262,729	1,276,394	-	-	1,262,729	1,276,394
Unrestricted	6,366,717	6,513,557	606,197	334,353	6,972,914	6,847,910
Total net assets	\$29,647,719	\$30,401,341	\$951,220	\$669,867	\$30,598,939	\$31,071,208

Net assets may serve over time as a useful indicator of a government's financial position. In Caroline County, assets exceeded liabilities by approximately \$30.6 million at the close of the most recent fiscal year, which is a decrease of \$0.5 million from the previous year.

By far, the largest portion of Caroline County's net assets, approximately \$22.3 million, reflects its investment in capital assets (e.g., land, buildings, machinery, and equipment), less any related outstanding debt used to acquire those assets. The County uses these capital assets to provide services to citizens; so these assets are not available for future spending. Although the County's investment in its capital assets is reported net of related debt, resources needed to repay this debt must be provided from other sources, since capital assets themselves should not be used to liquidate these liabilities.

An additional \$1.3 million of the County's net assets are subject to external restrictions on how they may be used. The remaining balance of unassigned net assets of \$6.9 million may be used to meet the County's ongoing obligations to its citizens and creditors.

At the end of the current fiscal year, Caroline County is able to report positive balances in all three categories of net assets for the government.

Changes in Net Assets

The following table indicates changes in net assets for governmental and business-type activities for the last two fiscal years:

	Governmental Activities		Business-type Activities		Total	
	2012	2011	2012	2011	2012	2011
Revenues:						
Program revenues:						
Charges for services	\$1,687,133	\$1,770,873	\$2,572,036	\$2,220,506	\$4,259,169	\$3,991,379
Operating grants	2,698,940	3,630,075	552,407	585,950	3,251,347	4,216,025
Capital grants	936,037	890,235	0	0	936,037	890,235
General revenues:						
Property taxes	23,932,023	23,892,084	0	0	23,932,023	23,892,084
Other taxes	12,489,087	12,323,263	0	0	12,489,087	12,323,263
Operating grants (Unrestricted)	2,486,371	2,131,782	0	0	2,486,371	2,131,782
Other	20,076	(60,536)	0	0	20,076	(60,536)
Total Revenues	44,249,667	44,577,776	3,124,443	2,806,456	47,374,110	47,384,232
Program Expenses:						
General Government	6,845,879	5,628,953	0	0	6,845,879	5,628,953
Public Safety	13,214,384	13,031,198	0	0	13,214,384	13,031,198
Public Works	4,573,494	4,908,094	0	0	4,573,494	4,908,094
Health	456,265	621,859	0	0	456,265	621,859
Social Services	133,412	1,267,129	0	0	133,412	1,267,129
Primary Education	14,109,214	13,498,500	0	0	14,109,214	13,498,500
Secondary Education	1,434,573	1,413,551	0	0	1,434,573	1,413,551
Recreation and Culture	1,172,538	1,153,486	0	0	1,172,538	1,153,486
Library	1,111,050	1,100,000	0	0	1,111,050	1,100,000
Conservation of Natural Res.	336,609	765,874	0	0	336,609	765,874
Economic Development	1,172,532	357,460	0	0	1,172,532	357,460
Public Housing	0	315,255	0	0	0	315,255
Interest On Long-Term Debt	1,118,515	1,435,458	0	0	1,118,515	1,435,458
Other	0	0	2,167,914	2,006,464	2,167,914	2,006,464
Total Expenses	45,678,465	45,496,817	2,167,914	2,006,464	47,846,379	47,503,281
Excess (Deficiency) before transfers	(1,428,798)	(919,041)	956,529	799,992	(472,269)	(119,049)
Net Transfers in (out)	675,176	3,975,947	(675,176)	(3,975,947)	0	0
Change in Net Assets	(753,622)	3,056,906	281,353	(3,175,955)	(472,269)	(119,409)
Net Assets – Beginning of Year	30,401,341	27,344,435	669,867	3,845,822	31,071,208	31,190,257
Net Assets – Ending	29,647,719	30,401,341	951,220	669,867	30,598,939	31,071,208

Governmental activities shows a decrease of \$753,622. Business-type activities showed an increase in net assets of \$281,353.

Governmental activities. Expenses are listed in the first column with revenues from that particular program reported to the right. The result is a Net (Expense)/Revenue. This format highlights the relative financial burden of each of the functions. This also identifies the amount each function draws from the general revenue, or if the function is self-supporting through fees and grants. It is important to note that all taxes are classified as general revenue, even if restricted for a specific purpose.

Property taxes increased by approximately \$40 thousand during FY 2012. This increase is less than the previous year's \$.6 million increase. The assessable base decreased again this year, primarily due to a decrease in property values of existing properties in the middle District, as assessed by the State of Maryland Department of Assessments and Taxation.

The local economy began to retract during FY 2008 and this trend has continued into FY 2012. FY 2012 continued unemployment and a declining real estate market have continued to erode revenues. Property taxes remained level despite the declining real estate market because although property assessments decreased the differential for the towns decreased by 5 cents.

The County Homestead credit is 5%, so primary residences have reduced assessments but not reduced taxes, therefore helping to maintain stable property tax revenue. As assessments reflect the decline in real estate value, an adverse affect on future property tax revenue will occur.

Business-type activities. The Recreation Programs Enterprise Fund was established to collect and record fees charged for recreation programming. Without the fee programs, the County would have to cut approximately 50% of the recreation programs currently offered to citizens. Recreation and Parks had a loss of \$ 47,457 in FY 2012 compared to an excess in FY 2011 of \$73,895.

The Emergency Medical Services (EMS) Fund or Basic Life Support (BLS) Fund was established to collect fees from patients of the system through insurance billing. The fees collected support both paid County EMS personnel and certified volunteers who provide services through a shared arrangement. Revenue collected through charges for services increased by \$256,595 from FY 2011 to FY 2012. Expenses of the programs increased \$14,233.

The Public Works Fuel Fund was established to separately account for fuel sales to 28 different departments and outside agencies including municipalities and State agencies, such as the Maryland State Police and the Department of Natural Resources. The purpose is to buy fuel in bulk at a less expensive rate; thereby saving fuel costs of the cooperating agencies. The 24-hour self-fueling facility allows convenience and centralized billing for fuel purchased; reducing down time and increases cross-governmental efficiencies. The fund generated an operating profit of \$48,858 an increase of \$13,696 compared to FY2011.

Combined business-type activities generated \$956,529 in net operating revenues over expenses, with \$675,176 transferred to governmental activities. This resulted in net assets increasing by \$281,353 from FY 2011.

Financial analysis of the County's Funds

Caroline County uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Governmental funds. The focus of the County's governmental funds is to provide information on near-term inflows, outflows, and balances of fiscal resources that can be spent. Such information is useful in assessing the County's financial requirements. In particular, unassigned fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

As of the end of the current fiscal year, the County's governmental funds reported a combined ending fund balance of \$7.5 million. Approximately \$3.5 million of the total constitutes unassigned fund balance, which is available for spending at the County's discretion. The remainder of the fund balance is reserved, indicating that it is not available for new spending because it has already been committed: 1) to liquidate contracts, purchase orders and capital commitments of the prior period; 2) as a revenue source for the FY 2013 budget; and 3) for contingencies.

The General Fund is the primary fund of the Caroline County Government. At the end of the current fiscal year, unassigned fund balance of the General Fund was \$3.5 million, while total fund balance was \$3.7 million. As a measure of the General Fund's liquidity, it may be useful to compare both unassigned General Fund balance and total General Fund balance to total General Fund expenditures

Fund balance of the General Fund increased from the previous year. The key factors are as follows:

- Revenues exceeded expenditures by \$ 627,956 in FY 2012.
- The ending fund balance was \$3,738,944
- Property tax revenue remained stable.
- Income tax increased \$460,473 from FY 2011.

In the FY 2012 budget, the Caroline County Commissioners took the following actions:

- Employees again did not receive merit or COLA raise. This combination puts a great burden on county staff.
- Departments were budgeted at flat or reduced budget compared to the FY 2011 budget.
- The County no longer is providing free trash collection sites for County residents. This action resulted in a convenience fee of \$100 per year for collection site drop off and a change in the town differential rates of 5 cents for town residents with municipal trash collection.

Fund balance of the capital improvement fund decreased by \$1,645,503. This reflected the yearly depreciation of assets without the ability to replace and repair current assets such as roads, buildings, vehicles and other items. It also reflected the decrease in the 2009 bond money for CRHS without an offsetting increase in asset as the school buildings are owned by the local Board of Ed.

Capital Reserve fund balance decreased by \$491,748. The \$450,000 anticipated to be used for debt payment was not needed so the Commissioners approved using \$700,000 of capital reserve for road resurfacing and some other needed capital projects.

Post employee benefits fund was established as a trust fund in FY 2009. There was no contribution for FY 2012. While this is not the commitment level desired by the County there were no available funds to contribute.

Proprietary funds. Caroline County's proprietary fund statements provide the same type of information found in the government-wide financial statements, only in more detail. Total net assets increased from \$669,867 in 2011 to \$951,220 in FY 2012.

General Fund Budgetary Highlights

There were some differences between the original budget and the final amended budget. Some points of interest:

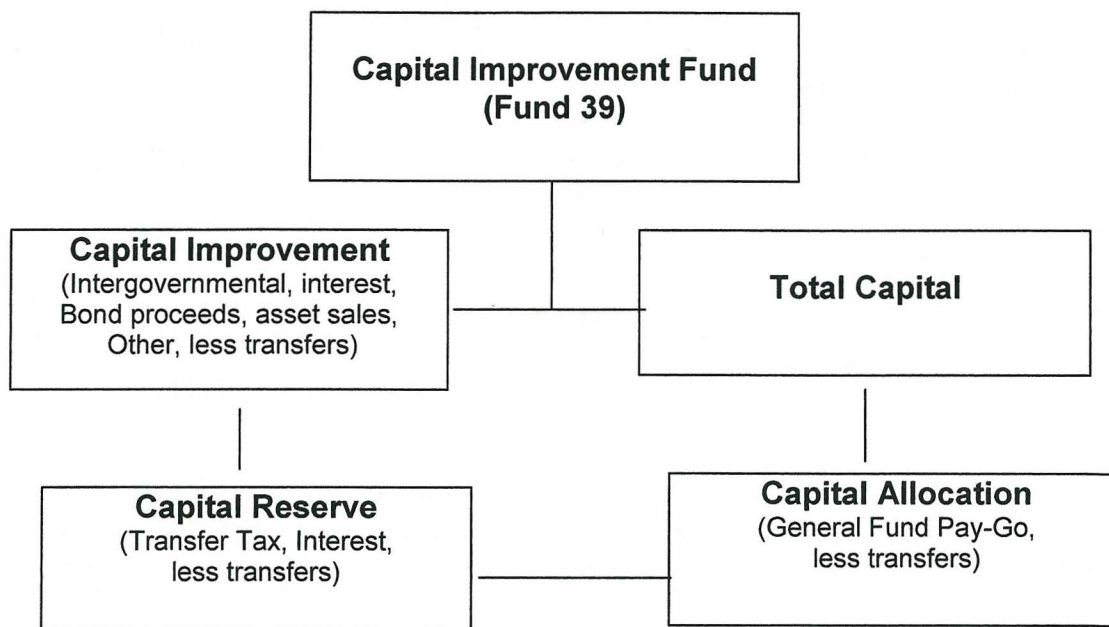
- Some Revenue sources did not meet projections.
- Income Tax exceeded expectation.
- Several departments spent less than the amount budgeted for their operation.
- The budget was designed to not use Fund Balance.
- Capital Reserve was budgeted to be used to offset debt but was not needed

Increases in fund balance are not expected in the near future due to the continuing uncertainty of the economy. The FY 2013 budget is not projected to use any fund balance, requiring departments to remain within budgeted amounts. Revenue projections are still extremely uncertain due to the slow economic recovery from recession. The shifting of the State Teachers Pensions to the Counties has begun and while, for Caroline County, FY 13 has an offsetting grant, the FY14-FY16 shift will require either a drastic cut in spending or an increase in revenue.

It is impossible for the management to accurately predict how the State will further address its structural deficit.

Capital Improvement Fund Highlights

The following diagram depicts the Capital Fund structure utilized by Caroline County, with the related revenue sources:



Caroline County develops a six-year Capital Improvement Program, with the current year being formally adopted as a budget. The difference between budgeted amounts and actual amounts may vary greatly, since much of the actual expenditures depend upon the timing of intergovernmental revenues (such as grants, program open space, state funding, state Waterway Improvement Funding, and other federal grant programs). Many of these grants are unpredictable, causing wide revenue differences between actual and budgeted amounts.

A second issue regarding capital budgeting is the timing of the expenditures. Expenditures may span several years for large construction projects to be completed. There is an inherent amount of unpredictability in developing the cost estimates for these capital projects, resulting in yearly differences. Overall economic conditions significantly affect these costs.

The Capital Reserve Fund depends upon transfer taxes and interest earned as its only revenue sources. The transfer tax is budgeted based upon estimated collections from transfers of properties. Transfer tax revenue declined from \$874,821 in FY 2007 to \$304,602 in FY 2012. By law, the Reserve fund balance cannot go below \$750,000. As of June 30, 2012, the balance was \$1,304,662. The Caroline County Commissioners passed legislation that in a financial emergency the fund balance can be reduced under the \$750,000.

Capital Asset and Debt Administration

Capital Assets. The County's investment in capital assets for its governmental and business-type activities as of June 30, 2012, amounts to \$58.1 million (net of accumulated depreciation). This investment in capital assets includes land, buildings and improvements, machinery and equipment, vehicles, and infrastructure. The County's investment in capital assets for the current fiscal year decreased slightly due to depreciation of assets. The Commissioners while not in a position to fund the capital projects necessary to keep the Counties assets in good condition were able to use unspent capital reserve money to fund some road resurfacing and some other much needed projects.

Capital asset activities are summarized as follows, net of accumulated depreciation:

Capital Assets, Net of Depreciation	Governmental Activities		Business-Types Activities		Total	
	2012	2011	2012	2011	2012	2011
Land and Land Improvements	\$12,913,511	\$13,095,598	\$0	\$ 0	\$12,913,511	\$13,095,598
Non-depreciable infrastructure	17,052,974	17,052,974	0	0	17,052,974	17,052,974
Construction in progress	255,683	1,730,429	0	0	255,683	1,730,429
Infrastructure	7,833,930	6,052,911	0	0	7,833,930	6,052,911
Buildings	12,248,014	12,991,921	345,023	335,514	12,593,037	13,327,435
Improvements	2,157,930	2,320,517	0	0	2,157,930	2,320,517
General capital assets	1,336,225	1,575,403	0	0	1,336,225	1,575,403
Vehicles	207,172	287,423	0	0	207,172	287,423
Machinery and equipment	3,736,257	4,464,207	0	0	3,736,257	4,464,207
				0		
Total	\$57,741,696	\$58,405,552	\$345,023	\$335,514	\$58,086,719	\$59,906,897

Additional information on the County's capital assets can be found in Note 6 of this report.

Long-term debt. At the end of the current fiscal year, the County had capital loans, conditional loans and bonds outstanding in the amount of \$34 million, which are backed by the full faith and credit of the County.

**Caroline County's Outstanding Debt
General Obligation Bonds**

June 30, 2012

	<u>Governmental Activities</u>	<u>Business-type Activities</u>	<u>Total</u>
General obligation bonds	\$30,875,000	0	\$30,875,000

During the current fiscal year, the County's general obligation debt decreased by \$ 3.1 million.

The County has a rating of "A3" from Moody's Investment Service and maintained an "A" rating from Standard & Poor's.

Additional information on the County's long-term debt can be found in Note 7 of this report.

Economic Factors and Next Year's Budget and Rates

- The unemployment rate for the County was 8.6% in June 2012. The State's average was 7.2%. ¹
- Real property tax revenue and all revenues are uncertain due to national and state economic characteristics resulting from the recession.

These factors, as well as many others, were considered in preparing the County's budget for Fiscal Year 2013.

County employees received no pay scale increase.

The State of Maryland budget problems have increased, and a deficit is projected going into FY 2013. It is uncertain how this will ultimately affect Caroline County. The shift of teacher's pensions to the local government in each county will commence in FY 13. While it does not have a negative impact in FY 13, there is an offsetting grant; the FY 14 thru FY 16 shift will present serious challenges in balancing our budgets. The State passed down 90% of the assessment cost to each county FY 2012.

1. Monthly Labor Review June 2012
www.dli.maryland.gov

Request for Information

This report is designed to provide a general overview of Caroline County's finances for all those with an interest in the County's finances. Questions concerning any information provided in this report should be addressed to:

Caroline County Administrator
Caroline County Government
109 Market Street
Room 123
Denton, Maryland 21629

Or, please visit our website at www.carolinemd.org